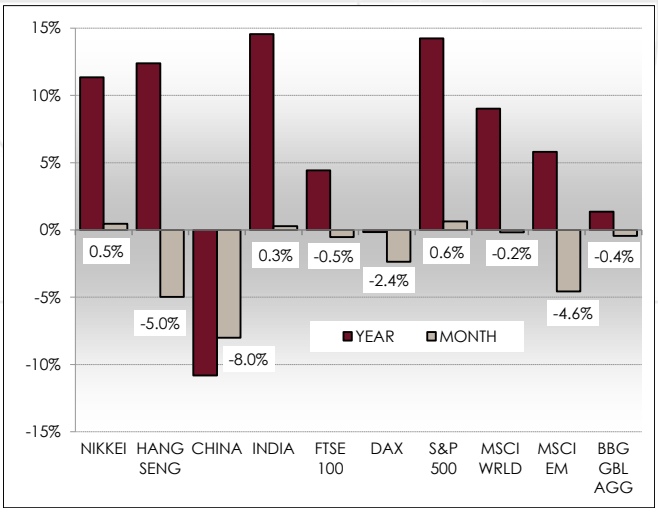
June in perspective – global markets

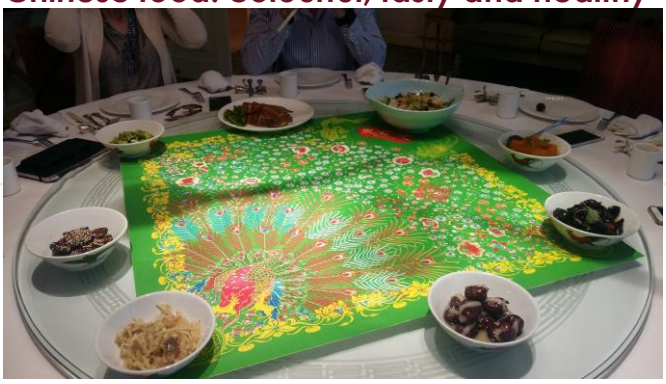
It is hard to believe that we are into the second half of 2018 already. I recall the bumper start we had to investment markets in January. It seems a bit like a dream right now, given how much the volatility and uncertainty has increased since then. While much progress has been made on certain fronts – who would ever have imagined a meeting between Donald Trump and Kim Jong Un, for example – a lot of damage has been done to market sentiment since the beginning of this year. Ironically, we now know that the global economy, and the US in particular, is still in good health, but the possibility of a trade war initiated by the US has spooked investors and called into question some of the higher-flying investment destinations, specifically within the emerging market space. There was no better month to see this story unfold than during June.

Chart 1: Global returns to 30 June 2018



For all the market volatility experienced during June, the US equity, bond, and currency markets proved to be bastions of strength. Their respective returns of 0.6%, -0.1%, and 0.5% bear testimony to the importance of the US economy and its markets during times of global uncertainty, despite the antics, character, and Twitter account of their president. The Japanese equity market rose 0.5% during June, but the UK and German markets lost 0.5% and 2.4%, contributing to a modest decline of 0.2% in the MSCI World index. Compare that to the 4.6% decline in the MSCI Emerging Market index, where Indonesia fell 3.1%, Turkey 4.1%, Brazil 5.2%, and China 8.0%. The Indian market, which rose 0.3%, was notably resilient but one needs to acknowledge that Turkey, Brazil, and to a lesser extent South Africa contributed to their own weakness based on specific developments in those countries. Most emerging market currencies weakened in the face of the strong dollar, the rand's decline of 7.6% being an obvious example. The Chinese yuan has been weak for a while now; investors in Chinese companies, especially those located outside of China, have really been spooked by the prospect of a trade war – Chinese shares are down more than 20% from their late-January peak and have declined 13.9% so far this year.

Chinese food: colourful, tasty and healthy



The strong dollar had a negative effect on most commodity prices, other than the oil price, which rose 1.4% to close to $80 per barrel. The prices of gold, palladium, and platinum declined 3.8%, 3.5%, and 6.0% respectively, while copper lost 2.8%. Soft (agricultural) commodity prices were particularly weak - the Bloomberg Commodity index lost 3.7% on the month. Despite the firm

dollar, most developed market currencies held their own and the global bond market, despite attracting a lot of news flow intra-month, was relatively steady. Bloomberg's Global Aggregate index declined only 0.4%.

Sea bass

What's on our radar screen?

Here are a few items we are keeping an eye on:

- *The SA economy*: The South African Purchasing Manufacturing Index (PMI) contracted to 47.9 in June from 49.8 in May, signifying lingering weakness in sentiment and business activity. Intensifying trade wars, pressure on input costs (prices paid rose to 73.6 from 65.5, the highest in 7 months) and renewed electricity supply interruptions weighed on business activity (45.8 from 47.2), new orders (49.1 from 51.5), purchasing commitments (45.0, unchanged) and employment (46.0 from 49.2). Inventories contracted again (47.9 from 49.4). Remember PMI indices signal growth or contraction: an index level above 50 signifies growth while a level below 50 signals contraction. A continuation of these trends will weigh heavily on growth prospects during the second half of this year (2H 18). The July inflation rate rose to 4.6%. The Reserve Bank left interest rates unchanged but reduced their 2018 growth forecast sharply, from 1.7% to 1.2%.
- *The US economy*: The PMI reading (in the US they are prepared by the Institute of Supply Manufacturers and are hence referred to as the ISM indices) "surprized to the upside" i.e. came in a lot better than expected, at a level of 60.2, up from 58.7 in May, close to its 60.8 February level, which remains the highest reading since 2004. The ISM Non-manufacturing index rose to a four-month high of 59.1. Annual core US inflation rose to 2.3%, its highest level since January 2017. The labour market continues to impress, with 213 000 jobs being created in June, bringing the average growth in jobs during the past six months to 215 000. The annual growth in wages is now 2.7% and the unemployment rate 4.0%. It is clear from recent data releases that the US will post strong second quarter growth.
- *Developed economies*: The final Eurozone PMI reading for June was 54.9, down from May's 55.0, marking the sixth consecutive monthly decline i.e. every month so far this year. This confirmed the slowdown in the Eurozone which we are watching closely. Germany's annual inflation rate is now 2.1% while in France it is 2.3%.
- *Emerging economies*: Turkey remains on the radar screen front and centre. Its annual inflation rate rose to 15.4% in June, from 12.2% in May, a 15-year high. Core inflation rose to 14.6% while producer inflation rose to 23.7%. It is no wonder therefore that the Turkish lira remains under enormous pressure, having declined 27.7% so far this year at the time of writing. The Central Bank of the Republic of Turkey (CBRT) has raised interest rates three times so far this year, by a cumulative 500 basis points (5.0%). The

CBRT's independence is at stake, after recently re-elected President Erdogan continued to rant against the high interest rates and appointed his son-in-law, who has no economic expertise or experience, as the new Minister of Finance. Indonesia's central bank, Bank Indonesia (BI) increased interest rates by 0.5% to 5.25%, bringing its cumulative increase since May to 1.0%. The Indonesian rupiah remains under some pressure, having fallen by 6.3% against the dollar so far this year, and the BI has continued to intervene in the bond and foreign exchange markets. India's trade deficit widened to a five-year high of $16.6bn in June from May's $14.6bn, driven by currency depreciation and higher oil prices. India imports about two-thirds of its oil needs, which are expected to grow. Should oil prices remain high, the 2019 current account deficit is likely to widen further from 1.9% of gross domestic product in 2018. India's annual inflation rate rose to 5.0% in June, driven by higher fuel inflation, even as food inflation came in lower than expected. Core inflation was 6.4%, while producer inflation surged to 5.8% from 4.4% in May, the highest in over four years. Finally, China grew at a rate of 6.7% during Q2, down from Q1's 6.8% but still above government's target rate of 6.5%. A deliberate slowdown in infrastructure spending was a prime reason for the slowdown in growth.

Charts of the month

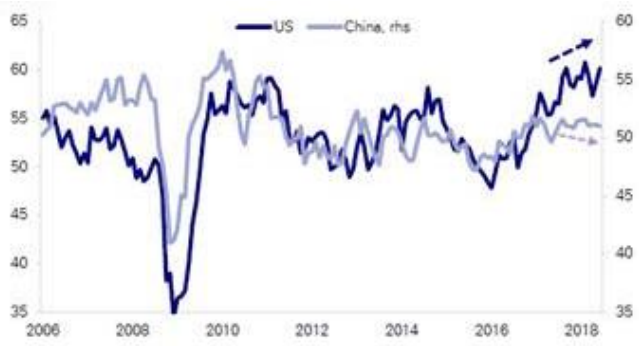
Growth, growth and more growth

At the time of writing the US economy has just reported its Q2 growth rate at 4.1%. China is growing at 6.7% but is slowing down. Let's be grateful for the high levels of growth in these two major economic blocs.

Roast duck, complete with beak

We often draw your attention to, and speak of, countries' Purchasing Manufacturer's indices or PMIs. I thought the following chart illustrated the difference between US and Chinese growth rather well (the chart was compiled before the release of US Q2 growth). Note that although both economies are growing at very healthy levels, the divergence in the rates of growth, as seen through their respective PMIs, is clear. The respective lines illustrate the countries' PMI indices – remember that any index value above 50 indicates the economy is growing, while a level below 50 is indicative of an economic contraction. Note from the chart, too, just how closely the two economies growth rates are intertwined.

Chart 2: US and China diverging growth

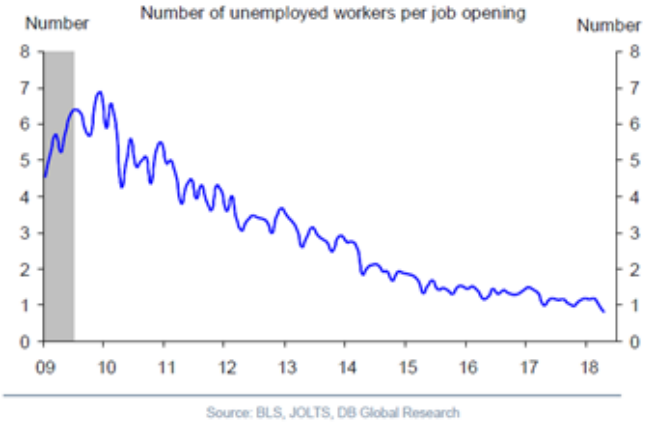


Source: Deutsche Bank

US labour markets – not much room left

We have commented several times on the robust US labour market and drawn your attention to the fact that there is, for all intents and purposes, no unemployment in the US. The following two charts illustrate that point well. Chart 3 shows that in 2010 there were 7 unemployed workers per job opening. Today there is less than one unemployed worker per job opening.

Chart 3: US labour market tightening



Source: Deutsche Bank

And in another indication of just how tight the US labour market has become, Chart 4 shows that, whereas during the peak of the last economic boom in 2006 and before the Great Financial Crisis it took 23 days to fill a job in the US – it fell to nearly 15 days in the depths of the crisis in 2009 – it now takes 31 days to fill a vacant job.

Chart 4: US labour market tightening

Source: Deutsche Bank

An encouraging aspect of US the equity market

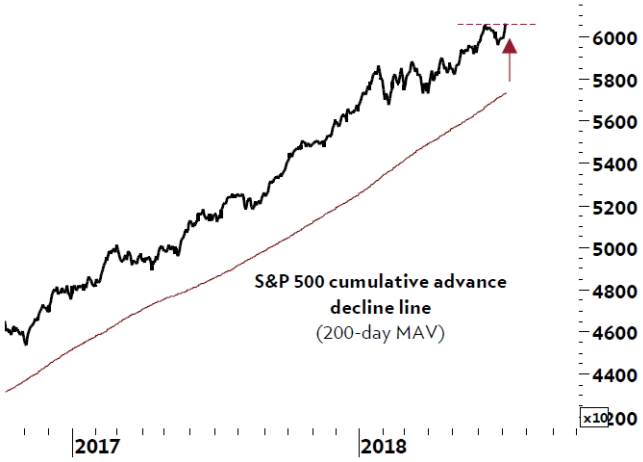
US equity markets have endured a rough time so far, having been characterized with a great deal of volatility and some nerve-wracking declines. This begs the question of their health – how secure, at least from a stability point of view, are US equity markets? One of the means we use to answer this question, is to analyze what is referred to as the breadth of the market. We typically use what is called the advance decline line to arrive at an answer to this question.

Calamari and tofu

"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

The cumulative advance decline line sums up the daily advances and decliners. Theoretically at least, a bull market usually peaks only when a minority of stocks are moving the index higher i.e. there is little breadth to the market. The integrity of a bull market is much better when most shares, rather than only a handful, are moving higher. Consequently, when the cumulative advance decline line reaches a new record or is close to a peak, it is indicative of a market in good health, by which we mean the advance prices of shares are spread across a lot of companies, and not just a few. In this regard you might like to re-read the June edition of *Intermezzo*, where we drew your attention to the fact that only 46 shares on the JSE had risen so far this year, and then only three had risen in excess of 20%. That is indicative of an equity market in poor health, and it is therefore not surprising to see how much the market has struggled this year.

Chart 5: US equity market depth and breadth



Source: Julius Baer

Chart 5 shows the cumulative advance decline line for the S&P500. The chart, which was drawn on 9 July, shows that the advance decline line has just reached a record high i.e. the general uptrend in prices is now more widespread than ever before. From this we can conclude that the state of the US equity market is good and the ongoing uptrend is well-supported and likely to continue, in the absence of an unexpected or extraneous shock, of course.

Dumplings: shrimps on top, soup inside

Quotes to chew on

Take his phone away!!!

I was amused by this comment from *Deutsche Bank's Jim Reid*, on 29 June: "It's amazing to think that by the close of business tonight the first half of the year will be wrapped up. Needless to say that it's been a bit more of a challenge in 2018 compared to last year with 1379 (and counting) separate President Trump Tweets needing dissecting. In fairness Trump's Twitter following is now up to 53 million and he's just overtaken Colombian singer Shakira for 18th position on the most followed accounts globally. Ironically CNN is in 17th position, the news agency Trump has famously branded as being 'fake news'".

More dumplings: steamed, vegetables inside

US recession? What recession?

It is fascinating to watch the debate on the future of the US economy and to a lesser extent the global economy. I can't recall a time when the views were so binary. There is a large portion of the investment community who are watching the "yield curve", which is jargon for the difference between interest rates on the 2- and 10-year US government bonds. When the rates on the 2-year bond exceed those on the 10-year bond, it is referred to as an "inverted yield curve", which has historically been one of the most accurate predictors of a US recession. The difference in yields (interest rates) has been narrowing for a while now, and at the time of writing is only about 0.3%. Based on history, there are good reasons to be concerned if one uses this indicator.

That said, the US has just released its Q2 growth rate, which saw the economy grow at the robust rate of 4.1%. Q1 growth was raised from 2.0% to 2.2% and many other indicators are pointing to the fact that the US economy is firing on all cylinders. So you will appreciate my comment about just how diverse and binary prevailing views are at present.

In the light of that, I thought *Deutsche Bank Chief International Economist Torsten Slok's* comments were apt: "Let's spend less time looking at the yield curve and more time looking at the economic data. Everyone who talks about late cycle and a recession coming soon should take a look at this chart (Chart 6).

Chart 6: Historic boom in US manufacturing

Source: Deutsche Bank

The US economy is producing the highest number of jobs in the manufacturing sector since 1998. This confirms the overarching investment theme across all asset classes today: The risks of overheating and overshooting inflation are much higher than the risks of a recession. In fact, this is the entire reason the Fed is so keen on raising rates a lot more from current levels."

An example of hyperinflation – and a failed state

Deutsche Bank's Jim Reid wrote the following in his Early Morning Reid, on 25 July: "On a fairly quiet day for headlines yesterday, one story really stood out. According to the IMF, Venezuela's inflation rate is expected to hit 1,000,000% by the end of this year, a situation only really comparable to Germany in the 1920s and Zimbabwe in the 2000s. It was only back in April that the IMF predicted inflation of 'just' 13,000% for Venezuela this year, which now looks tame by comparison. Instead their new forecast implies prices rising by about 3.9% a day. Quite unbelievable."

Watching the kitchen staff

Addiction to tech – parents take note

Local research company Avior reported on developments surrounding Tencent, the world's largest mobile gaming company, which are worth sharing. Tencent is the second largest holding in all Maestro's global equity portfolios.

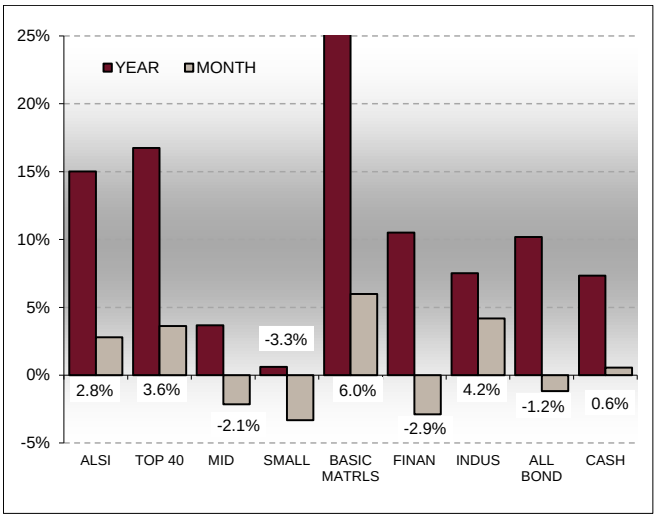
The news was as follows: "Tencent has announced new controls to be implemented on underage gamers of Tencent's popular games in China. Tencent recently set a control in place which would notify the account holder if more than RMB500 (about R1 000) was spent in a day. After receiving feedback that this limit is possibly too high, Tencent has now decided to place the RMB500 limit on spending over a 30 day period. Tencent has had backlash from the media on previous occasions, with the most publicized being last year when Tencent set time limits, a daily limit of 1 hour and preventing any logging in after 21h00 for users under the age of 12. Tencent has shown it does not take addiction and health issues lightly and has proven it can instill the necessary controls to prevent excessive use, especially by minors. Tencent further also has a strong relationship with China's Communist Party and it should be safe to assume that no unnecessary restrictions will be implemented by the government without proper consultation with Tencent."

Kitchen staff preparing the dumplings

June in perspective – local markets

Turning to the South African equity markets, the weak rand was a feature of the month. It pressurized the Financial index, which ended down 2.9%, and assisted large, global industrials (Naspers, for example), which saw the Industrial index end the month 4.2% higher. Despite weak commodity prices, the weak rand also assisted the Basic Materials index, which ended up 6.0% and help the All Share index post a 2.8% gain on the month. The firm rand's support for large industrials and mining shares helped the Top40 (Large cap) index rise 3.6%, while the opposite held true for the Mid and Small cap indices, which ended down 2.1% and 3.3% respectively. Despite unprecedented levels of sales of SA bonds by foreign investors, the All Bond Index declined only 1.2% - it is still up 4.0% for the first half of this year, whereas the All Share index is down 1.7% over the same period.

Chart 7: Local returns to 30 June 2018



The best-performing sector during June was the Media sector, which rose 15.2%. The Household Goods sector rose 15.1% (it was the worst performing sector last month, as Steinhoff "bounces along the bottom") and the Chemical sector 8.9%. The worst performing sector was the Automobiles and Parts sector, which lost 22.5%. The Industrial Engineering sector fell 15.6%, and the Construction and Materials sector 8.0%.

The Chinese hot-pot (fondue, sushi bar-like)

For the record

Table 1 lists the latest returns of the mutual and retirement funds under Maestro's care. Returns include income and are presented *after* fees have been charged. Fund Summaries for each respective fund listed in the table, as well as all the historic returns, are available on our website.

Table 1: The returns of funds in Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Prescient Fund	**Jun**	**3.7%**	**-3.2%**	**-1.4%**
JSE All Share Index	*Jun*	*2.8%*	*-1.7%*	*15.0%*
Maestro Growth Fund	**Jun**	**2.9%**	**2.6%**	**6.9%**
Fund Benchmark	*Jun*	*2.3%*	*1.2%*	*13.2%*
Maestro Balanced Fund	**Jun**	**2.5%**	**2.9%**	**7.4%**
Fund Benchmark	*Jun*	*2.1%*	*1.7%*	*12.4%*
Maestro Cautious Fund	**Jun**	**1.3%**	**0.4%**	**4.1%**
Fund Benchmark	*Jun*	*0.7%*	*2.2%*	*10.7%*
Central Park Global Balanced Fund ($)	**May**	**5.5%**	**6.8%**	**26.2%**
*Benchmark**	*May*	*-0.1%*	*-0.7%*	*6.4%*
*Sector average **	*May*	*-0.2%*	*-0.9%*	*4.2%*

* 60% MSCI World Index and 40% Bloomberg Global Aggregate Bond Index
** Morningstar USD Moderate Allocation ($)

File 13. Things almost worth remembering

Facebook's faceplant

By now I am sure you are aware of the ignominious record set by Facebook following the release of its results on 25 July. Without going into detail on the results, I am intrigued by the details of the *decline*, because it draws attention to just how large some of these tech companies are. We get accustomed to the brands, but the size of the companies based on their market capitalization (market cap) are so large it is hard to conceptualize just how big they are.

So here are some details to place Facebook's 20% decline after their results into perspective. In sheer numbers the company lost $120bn of its market cap. The decline was the largest loss in market cap by a single company ever recorded in history. To put that number into perspective, the decline is equivalent to the sum of the smallest 20 S&P500 companies by market cap, and larger than corporate giants such as

General Electric or Goldman Sachs. It is also larger than the entire Argentine stock market.

South African President Cyril Ramaphosa has set an objective of raising $100bn in new foreign investment into the country and has tabled a 5-year time horizon to achieve this. Facebook lost more than this is a matter of minutes! The loss in size (market cap) of Facebook in the minutes after its results release equates to approximately the size of Naspers, the largest company by far on SA's equity market, or the equivalent of half of South Africa's GDP.

Notwithstanding the above comments, in the interests of context Facebook rose 40% in recent months following the controversy surrounding the Cambridge Analytica scandal. This move alone added $230bn to the company's market cap, so the $120bn loss following the publication of its results should be seen in context. Again, it brings home the sheer size of these tech giants.

Jasmin tea exhibited during a tea ceremony

Speaking of large numbers

Whilst on the topic of large numbers, on 29 June four of the largest banks in the US reported their second quarter results. This event was followed by the US Federal Reserve releasing the results of their stress tests for the banking system, officially known as the 2018 Comprehensive Capital Analysis and Review. The results were generally favourable, with all of the large US banks comfortably passing the tests. Immediately after the stress test release, the four largest banks, being Wells Fargo, JP Morgan, Citigroup and Bank of America, announced a cumulative distribution, comprising dividend payments and share buybacks, of $110bn. It is a timely reminder of just how large these companies are.

The power of disruptive technology

We often hear of technology and tech companies loosely described as being disruptive. Those who are close to the industry or who have experienced it firsthand will know exactly how powerful a force this disruption can be. It is often the very large tech companies that are the most disruptive, given their sheer intellectual and financial muscle. At the end of June we saw a "prime" example (no pun intended) of this.

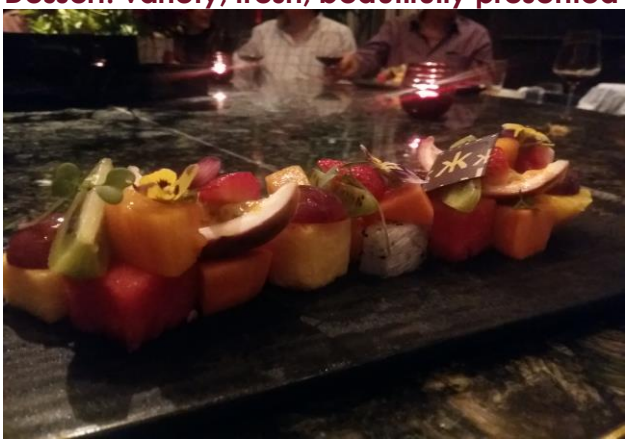
Amazon is probably one of the most notorious and effective disruptors in the world. It has encroached on many global industries, with devastating effects on prevailing incumbents, bricks and mortar retail being one of the largest casualties. On 29 June Amazon announced the purchase of an unlisted online retailer PillPack. PillPack holds pharmacy licenses in 50 states, providing Amazon with a wide range of potential customers. Amazon's announcement led to the immediate decline in market capitalization of USD18bn across the listed healthcare service providers, drugstores and drug distributors industry. This is a good example of how disruptive tech and large tech companies can be, and we are only talking about the financial aspects of their disruption here, not even the actual physical effect it has on industry and consumers.

Brexit – from bad to worse

While we are not experts on the United Kingdom or its policies, the Brexit decision always seemed a strange one to us, one that made no economic sense and that would have very negative economic consequences for the UK. The political circus that has ensued since the initial Brexit decision vindicates our view and we note that the greatest advocates of Brexit have all exited the political stage, leaving the prevailing politicians to muddle through in a high-stakes, high profile fiasco, where it honestly seems no one in the UK agrees on the way forward and no one knows which direction to take. Maestro exited all its UK investments a few years ago already; so far this has proved the correct decision. We are of the humble view that the most negative long-term effects of Brexit have yet to be felt by the UK and its people. The stakes are high and the UK has a lot to lose.

During the past week, Deutsche Bank put out a research report indicating that one of the biggest impacts of Brexit will probably be felt in the financial industry and within that by investment banks. The region's central hub, London, is likely to lose its full access to the single European market. The report provided some interesting statistics: at 6.6% of national gross value added Britain has the largest financial sector among major European countries, relative to the size of its economy. Financial services exports play a major role, and 44% of them go to the European Union (EU). Without the surplus it generates from providing investment banking services to EU customers, Britain's current account deficit would be 40% higher! This is just one example of how much is at stake in the Brexit game. From our perspective the prospect of the UK emerging on the right side of the deal are looking pretty slim.

Dessert: variety, fresh, beautifully presented



The rapidly moving world of technology

It is easy to read about technology advances like autonomous vehicles and artificial intelligence (AI) and think these technologies are close to being implemented. That would be a big mistake: in many places in the world they are already a reality. Many cities have already rolled out driverless vehicles and their production is in full swing. They are not part of the future – in many countries they are the present.

The following report from Avior illustrates this point: "(Chinese tech company) Baidu and (Japanese tech investor) Softbank's subsidiary, SB Drive, have partnered to launch Baidu's autonomous buses in Japan. Baidu's buses are currently equipped with the search engine's Level 4 autonomous system i.e. in certain conditions vehicles control all driving. The buses, which will start off with only 10, will be exported from China to Japan, being the first autonomous vehicle exports from China. Baidu further plans to launch its autonomous bus service in China mainland hubs, Beijing, Shenzhen, Pingtan and Wuhan. Autonomous technology is seen as a "face" of AI tech's capabilities, with all the tech giants focussed on developing the needed software."

Meals are unhurried communal affairs

So what's with the pics?

For the past two months I have shared some experiences of my recent trip to China with you. I do so again this month, but for the last time. I have shared my experiences in the hope that you will learn something new about China, and that you will question the usual China narrative we receive in the Western media.

Vegetables presented as part of the meal

This month I share some of my cuisine and eating experiences. This was another highlight of my trip: meal times in China are very special. They are communal, unhurried affairs. Everyone sits in a circle and all around the table are acknowledged and included. Food is shared slowly and there is no such thing as piling your plate full of food while others wait for you. Typically a lazy Susan allows the food to be circulated and you take one small piece of food from the large variety in small dishes that is on offer. This approach to eating together sets the Chinese culture apart from our Western one. The food was healthy, colourful, full of variety and exceptionally tasty. It was a real eye-opener and will remain a lasting memory of an exceptional life experience. I encourage all who haven't been to China yet to try and get there and experience for yourself what the future looks like. You will be pleasantly surprised.

Starters: dumplings, prawns, caviar and more